



Fiscal Year 2014 Annual Report

March 24, 2015

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I. Introduction

The Annual Report for the Trust Fund for the People of the Federated States of Micronesia (the Fund) is presented per Article 20 of the Trust Fund Agreement between the governments of the United States and the Federated States of Micronesia:¹

“Within six months of the end of each Fiscal Year, the Joint Trust Fund Committee shall publish and shall submit to the Government of the United States and to the Government of the Federated States of Micronesia:

- (a) an annual report on the activities and management of the Fund, including on the operations of the Accounts described in Article 16 of this Agreement, and on the effectiveness of the Fund to accomplish its purpose as described in Article 3 of this Agreement, which annual report may include recommendations regarding improving the effectiveness of the Fund to accomplish that purpose;*
- (b) the accounts of the Fund for that year audited in accordance with Article 19; and,*
- (c) reports of the Auditor under Article 19.”*

All documentation provided pursuant to Article 20 should be considered together.

The Annual Report’s information is mainly sourced from the annual financial statements prepared by the Fund’s accountant and verified by the Fund’s auditor, and quarterly investment reports prepared by the Fund’s Investment Adviser with information from the Custodian. Any questions or comments regarding the Annual Report can be sent to Anthony Costanzo, Executive Administrator, at apcostanzo@bgsi.net.

The Trust Fund Committee (the Committee) approved the Annual Report on 24 March 2015.

Summary highlights for FY14 are:

- The Fund’s total net position value increased 17.9% to \$380,901,011 in FY14 from \$323,083,136 in FY13. The increase was primarily due to a contribution from the United States government of \$26,104,960 and net investment income of \$31,867,396.
- The Fund had a dollar-weighted annual rate of return of 8.72% for FY14 compared to 13.47% for FY13 and 14.78% for FY12. Gains in the last 3 years have helped to offset negative performance in FY08, FY09 and FY11.
- Given the positive return, an allocation of \$9,895,700 was made to the “C” account for FY14 bringing the total of that account to \$73,672,363.

¹ The full text of the Agreement between the Government of the United States of America and the Government of the Federated States of Micronesia Implementing Section 215 and 216 of the Compact, as Amended, Regarding a Trust Fund (the “Trust Fund Agreement”) and other relevant documents is available at www.uscompact.org.

II. Trust Fund Background, Committee Updates, Contributions and Service Providers

A. Trust Fund Background

The Compact of Free Association, as Amended (the “Amended Compact”) -- as codified in the Compact of Free Association Amendments Act of 2003 (US Public Law 108-188, December 17, 2003; “the Amended Compact Act”) -- under Title Two: Economic Relations, Section 215, provides for the establishment of a trust fund in accordance with the Trust Fund Agreement between the Original Parties: the United States government (US government) and the Federated States of Micronesia government (FSM government). Sections 215 through 217 of the Amended Compact set forth the funding to be contributed by both governments to 2023.

The Fund was incorporated as a non-profit corporation under the laws of the District of Columbia in August 2004. The Trust Fund Agreement is supported by a set of by-laws initially approved by the Committee on 24 March 2006. Resolutions are considered and approved periodically to improve the overall management and operations of the Fund, as determined by the Committee. The Investment Policy Statement provides the Fund’s main investment guidance. The latest version of the Investment Policy Statement was approved in September 2010 and was most recently amended in December 2013.

As stated in Article 3 of the Trust Fund Agreement:

“The Purpose of the Fund is to contribute to the economic advancement and long-term budgetary self-reliance of the Federated States of Micronesia by providing an annual source of revenue, after Fiscal Year 2023, for assistance in the sectors described in Section 211 of the Compact, as amended, or other sectors as mutually agreed by the Original Parties, with priorities in education and health care.”

The broad investment objective, as set forth in the Investment Policy Statement, is to:

“maximize investment returns, subject to constraints aimed at containing fluctuations in returns over shorter periods within acceptable limits. Over shorter periods, outperformance will be sought relative to the notional return on a benchmark portfolio designed to reflect the risk profile according to which the assets are invested at the time.”

B. Trust Fund Committee Updates

Under Article 7 of the Trust Fund Agreement, the Trust Fund Committee’s functions include overseeing the:

1. Operation, supervision, and management of the Fund;
2. Investment and distribution of Fund resources; and

3. Conclusion of agreements and arrangements with Subsequent Contributors and other organizations.

For FY14, the Committee consisted of 5 members. According to the Trust Fund Agreement, the US government maintains a majority of voting members including the Chairman. The FSM government appoints two voting members. Other voting or non-voting members may be appointed from Subsequent Contributors. Currently, the Fund does not have any Subsequent Contributors.

The FY14 Committee members were:

1. Nikolao Pula, Chairman (Department of the Interior), US
2. Evelyn Adolph, Member (Office of Statistics, Budget and Economic Management, Overseas Development Assistance and Compact Management), FSM
3. J. Paul Reid, Member (Department of State), US
4. Aren Palik, Member (Private Sector), FSM
5. Jeanette Lim, Member (Department of Education), US

Evelyn Adolph replaced Willy Kostka in May 2014. J. Paul Reid replaced Dan Larsen in July 2014. Jeanette Lim replaced Craig Allen in July 2014.

The Committee met quarterly during FY14 to review investment performance and conduct Fund business on the following dates. Minutes were recorded, approved and signed for each meeting.

1. 17 December 2013 (Washington, DC-based teleconference)
2. 11 March 2014 (Washington, DC-based teleconference)
3. 4 June 2014 (Washington, DC-based teleconference)
4. 25 August 2014 (Honolulu, HI)

The Committee approved 3 resolutions in FY14. Following are the title and brief description of each resolution.

FSM Resolution 2014-1 Fixed Income Asset Category Adjustment

Following an adjustment of the Investment Adviser's fixed income fund, the Committee approved an adjustment to include the Fund's fixed income strategy to invest in a Mercer Core Fixed Income Fund and Mercer Opportunistic Fixed Income Fund and adjusted the target allocation to these funds to 2.5% and 16.5%, respectively. The Committee also approved liquidating holdings in Shenkman Capital Management (a convertible bond fund) and Ashmore Investment Management (an emerging market debt fund) and eliminating their respective categories from the Investment Policy Statement. The managed asset fee was also increased to 63 basis points from 58 points as a result of this adjustment. The managed asset fee increase was less than the money manager fees eliminated with the liquidation of the Shenkman and Ashmore assets.

FSM Resolution 2014-2 *FSM Trust Fund Annual Report, Fiscal Year 2013*
 Approved the FY13 Annual Report and approved the transmission of the Annual Report and Audited Financial Statements to the respective governments.

FSM Resolution 2014-3 *Engagement Agreement with Bookminders for Accounting Support Services*
 Approved a service proposal with Bookminders for accounting services to August 2015.

C. Contributions to the Fund

Contributions to the Fund by the US and FSM governments are governed by the schedule in Section 216 of the Amended Compact. The US government is obligated to contribute \$16 million in FY04 through FY06 and to contribute \$16 million, plus a cumulative amount that increases by \$0.8 million annually beginning in FY07, until FY23. This additional amount corresponds to the amount by which direct sector grant assistance is reduced in that fiscal year. A partial inflation adjustment is also added to the amount of the US contribution as indicated in the Amended Compact.² The FSM government was to contribute at least \$30 million prior to 30 September 2004. Initial contributions began in FY05 as the U.S. contribution was dependent on the FSM contribution that occurred in FY05.

Per Table 1, the US contributed \$26,104,960 on 21 October 2013.

Table 1: Contributions to the Trust Fund through FY14
 Dollars in millions

Year	US	FSM	Total
FY04	0.00	0.00	0.00
Date Contributed			
FY05	32.19	30.30	62.49
Date Contributed	10/5/04	10/1/04	
FY06	16.44		16.44
Date Contributed	10/6/05		
FY07	17.69		17.69
Date Contributed	10/6/06		
FY08	19.00		19.00
Date Contributed	10/9/07		
FY09	20.91		20.91
Date Contributed	10/6/08		
FY10	21.52		21.52

² As stated in Section 217 of the Amended Compact, the US government contribution “shall be adjusted for each United States Fiscal Year by the percent that equals two-thirds of the percent change in the United States Gross Domestic Product Implicit Price Deflator, or 5 percent, whichever is less in any one year, using the beginning of Fiscal Year 2004 as a base.”

Year	US	FSM	Total
Date Contributed	10/2/09		
FY11	22.39		22.39
Date Contributed	10/14/10		
FY12	23.59		23.59
Date Contributed	10/14/11		
FY13	24.99		24.99
Date Contributed	10/4/12		
FY14	26.10		26.10
Date Contributed	10/21/13		
Invested to Date	\$224.82	\$30.30	\$255.12

Source: Trust Fund for the People of the Federated States of Micronesia
Financial Statements, September 30, 2014 and 2013

D. Service Providers

Executive Administrator

The Fund contracts an Executive Administrator who serves in support of the governance, administration and operations of the Fund. The current Executive Administrator began providing services in April 2011 and is contracted through April 2015 per Resolution FSM 2013-3.

The Executive Administrator's key duties are to maintain all official Committee documents and records; update the Chairman and Committee members on Fund activities; maintain agreements with and coordinate Fund service providers; provide administrative services regarding payments, decisions and deliberations; assist in audit preparation and prepare the annual report; prepare periodic performance and other assessments to inform Committee members and staff; organize, conduct and provide follow-up for the four quarterly review meetings including meeting agenda, support documents and meeting minute preparation; and coordinate with US and FSM government members and staff in support of the above activities.

Custodian

State Street Bank and Trust Company (State Street), as the Custodian, provides all the services of the Trust Fund Agreement's Article 13, per below, with the exception of the record keeping function.

- Collect and receive any and all money and other property of whatever kind or nature due or owing or belonging to the Fund.
- Follow written directions of the Committee with respect to retention, purchase, sale or encumbrance of trust property and the investment and reinvestment of principal and income.
- Disburse income or corpus only pursuant to the conditions set forth in the Trust Fund Agreement.
- Make all payment of liabilities and administrative expenses.
- Maintain a web site portal for Fund financial information.

- Provide plan accounting that helps track each contributor's balance and the C account.³

State Street's fee is 3 basis points annually of the Fund's value assessed quarterly plus an additional flat fee -- a Supplemental Custody and Accounting Fee. State Street has served as Custodian since September 2010.

Investment Adviser and Money Managers

Mercer Investment Management, Inc. (Mercer), serves as Fund Investment Adviser and as a Money Manager, providing the services described in Article 14 of the Trust Fund Agreement. The Fund also engages other Money Managers with non-discretionary oversight provided by Mercer. Key services provided include:

- Advise and recommend to the Committee one or more Money Managers who will invest the assets of the Fund to produce a diversified portfolio.
- Provide the Committee with data relating to any prospective Money Manager, indicating performance and relevant comparisons with similar Money Managers to assist the Committee in evaluating the performance of the prospective Money Managers.
- Direct trades and manage liquidity, amongst other Money Manager-type functions.
- Provide monthly and quarterly performance reports on all Fund assets and compare performance to agreed upon industry standard benchmarks and to similar trusts, endowments and foundations within the Mercer client pool.

Mercer has served as the Fund's Investment Adviser since 2005. Mercer is currently engaged under a contract between Mercer and the Committee signed in September 2010. Mercer's managed asset fee (including sub-advisors) is 63 basis points annually. It is assessed daily with one part of the managed asset fee as compensation for Mercer's services and another as compensation to underlying Money Managers who are independent of Mercer. The fee rate was agreed to in December 2013 per FSM Resolution 2014-1 Fixed Income Asset Category Adjustment, as described above, which was applied beginning in February 2014.

In addition, Mercer applies a 9 basis point annual advisory fee on the non-discretionary assets. Each of the non-discretionary asset allocations has a Money Manager. Each non-discretionary Money Manager charges its own rates on the assets it invests which range from 0.70 to 1.25 basis points. These Money Managers are identified in Table 3, below, under Non-Discretionary Funds. The fee schedule is provided as Attachment 1.

Accountant

Bookminders has prepared the Fund's financial records since inception in 2004. Bookminders produces monthly financial statements and the annual financial statements that include the year-end reporting package with supporting schedules for the annual audit. The service agreement with Bookminders was extended by one year through August 2015.

³ Plan accounting is a breakdown of the Fund by contributor (US and FSM governments) and by the A and C account. The breakdown allows the allocation of contributions, investment gains and losses, and expenses to each contributor and helps to calculate the proportions of each contributor of the A and C accounts.


Auditor

Baker Tilly Virchow Krause, LLP serves as the Fund's auditor. Baker Tilly conducts the audits in accordance with US Generally Accepted Auditing Standards and Generally Accepted Government Auditing Standards issued by the Comptroller General of the United States. The Committee engaged ParenteBeard, LLC in May 2013 to prepare the FY13 and the FY14 audits. ParenteBeard has performed the annual audits dating back to FY04. On 1 October 2014 ParenteBeard LLC combined with Baker Tilly Virchow Krause, LLP. The service agreement for the FY14 audit was not changed.

Legal Counsel

Vorys, Sater, Seymour and Pease LLP (Vorys) provides support, as requested by the Committee, on any legal matters per a Letter of Engagement and Representation. Vorys has served as legal counsel since February 2012.

III. FY14 Account Balances and Performance

A. Changes to Trust Fund Asset Classes and Allocations

The major asset allocation change for FY14 was an adjustment of the fixed income portfolio. Per Resolution FSM 2014-1 Fixed Income Asset Category Adjustment, Shenkman Capital Management (a convertible bond fund) and Ashmore Investment Management (an emerging market debt fund) were liquidated and removed from the non-discretionary component of the portfolio. The fixed income strategy of the managed asset component of the portfolios was adjusted to include the Mercer Core Fixed Income Fund and the Mercer Opportunistic Fixed Income Fund.⁴ The Investment Policy Statement was adjusted accordingly to eliminate the fixed income holdings within the non-discretionary component of the portfolio and increase the fixed income target allocation under the managed asset component of the portfolio (to 19%, per Table 2, below).

For FY14, the portfolio's managed assets consisted of US equity (small, medium and large cap asset strategy), non-US equity (international developed and emerging market asset strategy), and fixed income. During FY13 a hedge fund and private equity fund, both "funds of funds," were added to the managed assets portion of the portfolio.⁵ For FY14, the portfolio's non-discretionary component consisted of private real estate, a hedge fund and private equity.

The Investment Policy Statement asset allocations and targets are provided in Table 2 and the individual asset changes are provided in Table 3. No major changes occurred except for the execution of the allocations within the fixed income asset strategy per the amended Investment Policy Statement.

Table 2: Investment Policy Statement Asset Allocations and Targets, FY13 and FY14

Asset Class	Strategic Target Allocation & Permitted Range 9/30/13	Strategic Target Allocation & Permitted Range 9/30/14	Allocation as of 9/30/13	Allocation as of 9/30/14	Actual % Difference
Managed Assets					
Domestic Equity	25.5% 20.5%-30.5%	25.5% 20.5%-30.5%	28.6%	28.3%	-0.3%
U.S. Large Cap Equity	18%	18%	20.9%	20.6%	-0.3%
U.S. Small/Med Cap Equity	7.5%	7.5%	7.7%	7.7%	0.0%

⁴ The Core Fixed Income Fund mainly consists of US Treasury instruments and high quality corporate debt. The Opportunistic Fixed Income Fund holds a diverse portfolio of high yield US public bond and debt instruments and emerging market debt.

⁵ A "fund of funds" is a combination of multiple independent funds managed by sub-advisers who are contracted to Mercer.

Asset Class	Strategic Target Allocation & Permitted Range 9/30/13	Strategic Target Allocation & Permitted Range 9/30/14	Allocation as of 9/30/13	Allocation as of 9/30/14	Actual % Difference
Non-U.S. Equity	25.5% 20.5%-30.5%	25.5% 20.5%-30.5%	28.5%	26.6%	-1.9%
Fixed Income	2.5% 0%-5%	19% 14%-24%	2.6%	19.8%	17.2%
Core Fixed Income		2.5%	0.0%	2.7%	2.7%
Opportunistic Fixed Income		16.5%	0.0%	17.1%	17.1%
Hedge Fund (Managed)	5.5% 3%-8%	5.5% 3%-8%	5.3%	4.8%	-0.5%
Private Equity Fund (Managed)	0% 0%-10%	0% 0%-10%	0.4%	1.3%	0.9%
Total Managed Assets	59%	75.5%	65.4%	80.8%	15.4%
Non-Discretionary Assets					
Emerging Market Debt	10% 5%-15%	0%	8.3%	0.0%	-8.3%
Convertible Bonds	6.5% 4%-9%	0%	6.1%	0.0%	-6.1%
Private Equity*	9.5% 0%-10%	9.5% 0%-10%	6.0%	5.0%	-1.0%
Private Real Estate	10% 5%-15%	10% 5%-15%	9.4%	9.8%	0.4%
Hedge Fund	5% 2.5%-7.5%	5% 2.5%-7.5%	4.7%	4.3%	-0.4%
Cash	0% 0%-3%	0% 0%-3%	0.1%	0.1%	0.0%
Total Non-Discretionary	41%	24.5%	34.6%	19.2%	-15.4%
Total	100%	100%	100.0%	100.0%	

* Allocation to Non-Discretionary Private Equity will shift to Managed Assets Private Equity as capital is called for that fund.

Source: Investment Policy Statement, 12/13 Amendment; Mercer Quarterly Reports- 9/30/13 and 9/30/14.

Table 3: Asset Change FY13 to FY14

Asset Class	Assets Held as of 9/30/13	Assets Held as of 9/30/14
Managed Assets		
Domestic Equity		
US Large Cap Equity	SSgA S&P 500 Index Fund	SSgA S&P 500 Index Fund
US Small/Med Cap Equity	Mercer Small/Mid Cap Growth Equity Fund	Mercer Small/Mid Cap Growth Equity Fund
	Mercer Small/Mid Cap Value	Mercer Small/Mid Cap Value

Asset Class	Assets Held as of 9/30/13	Assets Held as of 9/30/14
	Equity Fund	Equity Fund
Non-US Equity	Mercer Non-US Core Equity Fund Mercer Emerging Markets Equity	Mercer Non-US Core Equity Fund Mercer Emerging Markets Equity
Fixed Income	Mercer Core Fixed Income Fund Mercer Opportunistic Fixed Income	Mercer Core Fixed Income Fund Mercer Opportunistic Fixed Income
Hedge Fund	Mercer Hedge Fund Investors	Mercer Hedge Fund Investors
Private Equity	Mercer Private Investment Partners III	Mercer Private Investment Partners III
<i>Non-Discretionary Funds</i>		
Emerging Market Debt	Ashmore Investment Management	NA
Convertible Bonds	Shenkman Capital Management	NA
Private Equity	HarbourVest Partners- VIII Venture Fund; VIII Buyout Fund; VIII Mezzanine & Distressed Debt Fund; Private Equity V Portfolio Advisors Private Equity Fund I	HarbourVest Partners- VIII Venture Fund; VIII Buyout Fund; VIII Mezzanine & Distressed Debt Fund; Private Equity V Portfolio Advisors Private Equity Fund I
Private Real Estate	Prudential Real Estate Investors	Prudential Real Estate Investors
Hedge Fund	Blackstone Alternative Asset Management	Blackstone Alternative Asset Management

Note: NA means Not Applicable since there were no holdings of such assets.

Source: Trust Fund for the People of the Federated States of Micronesia Investment Performance, September 30, 2013 and September 30, 2014, Mercer Investment Management.

Fund performance is measured utilizing a set of performance standards established in the Investment Policy Statement. Individual asset class benchmarks are identified in the Statement, and the Investment Adviser also measures performance according to its Total Trust Benchmark and Foundation Performance Universe Median. A summary of benchmarks for the entire Fund and for each asset class is provided as Attachment 2. Table 6 provides information on the Fund's annual performance compared to the relevant benchmarks.

B. Summary of FY14 Performance and Expenses

The Fund ended FY14 with a net position of \$380,901,011. The amount is a 17.9% gain from FY13, as shown in Table 4. The gain is attributable to two factors: continued and increasing US contributions and investment earnings.

The US contribution increased to \$26,104,960 based on the FY14 scheduled amount per the Amended Compact, including the partial inflation adjustment. No other contributions were provided to the Fund.

Net investment income was \$31,867,396, a decrease from the \$40,897,014 gain in FY13. Investment income was mainly a result of interest, dividends, and realized and unrealized gains on investments. Annual net positions since inception are provided in Attachment 3, Table A.

Table 4: Trust Fund Income Change FY13- FY14 and Percent Change

	FY13	FY14	% Change
Additions			
Contributions			
U.S. Government	<u>24,993,360</u>	<u>26,104,960</u>	4.4%
Investment Income			
Interest and dividends	4,886,086	12,348,471	152.7%
Net increase in the fair value of investments	<u>37,011,204</u>	<u>20,624,284</u>	-44.3%
Gross investment income	41,897,290	32,972,755	-21.3%
Less: Investment expenses			
	<u>1,000,276</u>	<u>1,105,359</u>	10.5%
Net investment income	<u>40,897,014</u>	<u>31,867,396</u>	-22.1%
Total additions	<u>65,890,374</u>	<u>57,972,356</u>	-12.0%
Deductions			
Administrative expenses	<u>153,346</u>	<u>154,481</u>	0.7%
Change in net position	65,737,028	57,817,875	-12.0%
Restricted Net Position, Beginning	<u>\$257,346,108</u>	<u>\$323,083,136</u>	25.5%
Restricted Net Position, Ending	<u>\$323,083,136</u>	<u>\$380,901,011</u>	17.9%

Source: Trust Fund for the People of the Federated States of Micronesia Financial Statements, September 30, 2014 and 2013

Note: Investment expenses do not reflect Money Manager fees directly subtracted from Fund asset values. These expenses are reflected in Table 5. Amounts rounded to the nearest dollar.

Total Fund expenses increased by 8.6% compared to FY13, per Table 5, but were reduced as a total percentage of the Fund's net position to 0.79% compared to 0.86% for FY13 continuing a downward trend in Fund expenses as such a percentage of net position from FY12. All expenses are within those rates agreed to by the Committee. Annual expense history since inception is provided in Attachment 3, Table B.

Table 5: Investment and Administrative Expenses, FY13 and FY14

	FY13	FY14	% Change
Investment Expenses	\$2,613,679	\$2,849,842	9.0%
Custodian	85,449	98,437	15.2%
Investment Adviser	359,658	402,713	12.0%
Money Manager	555,169	604,209	8.8%
Money Manager*	1,613,403	1,744,483	8.1%
% of Net Position	0.81%	0.75%	-7.5%
Administrative Expenses	\$153,346	\$154,481	0.7%
Executive Administrator	98,280	99,904	1.7%
Audit Fees	41,088	42,395	3.2%
Accounting Fees	5,893	6,059	2.8%
Legal Fees	2,889	376	-87.0%
Miscellaneous	5,197	5,747	10.6%
% of Net Position	0.05%	0.04%	-14.6%
Total Dollar Expenses	\$2,767,025	\$3,004,323	8.6%
Total % of Net Position	0.86%	0.79%	-7.9%

Note: Amounts rounded to nearest dollar.

* Money Manager Fees directly subtracted from Fund asset value.

Source: FY13 and FY14 Annual Audited Annual Financial Statements and Fund Data Collection

Custodian expense increased 15.2% mainly due to the Fund's increased value.

The Investment Adviser's expense increased 12.0% to \$402,713. Total Money Manager fees increased 8.3% to \$2,348,692.⁶ Money Manager fees are based on the amount of assets being managed. The investment expense increase was due to 1) the portfolio gaining 9.0% in value, net of fees (Table 6), the 2) the annual US contribution provided in October 2013, and 3) the increase of the Investment Adviser fee to 63 from 58 basis points resulting from the fixed income asset strategy adjustment as described previously. The Investment Adviser category also includes the 9 basis point fee for non-discretionary asset oversight by the Investment Adviser.

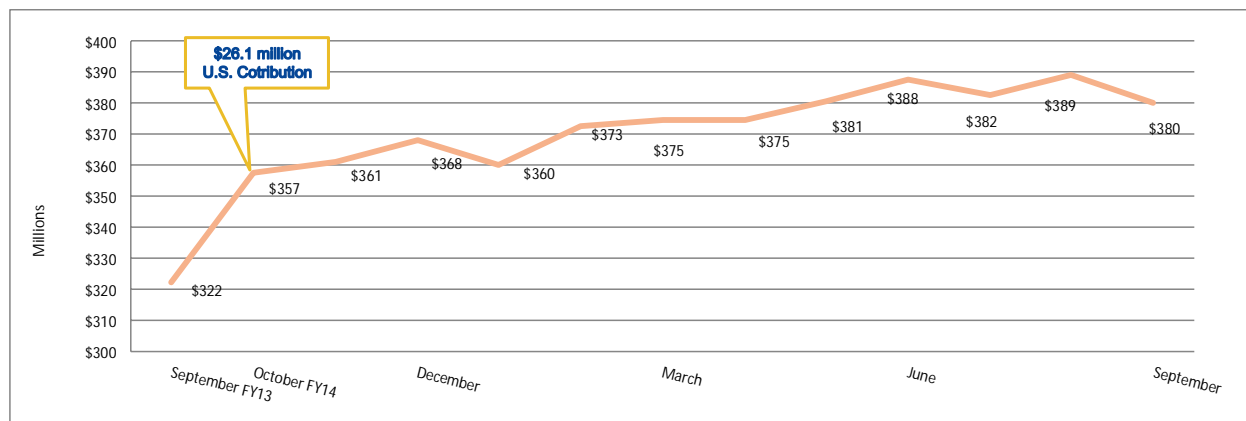
Total administrative expenses increased 0.7% for FY14. Slight dollar and percentage increases occurred for the Executive Administrator, audit and accounting fees with a more significant increase in miscellaneous expenses. Legal fees decreased significantly. Overall, administrative expenses continue to be a reduced portion of the total net position—0.04% compared to 0.05% for FY13-- the lowest percentage since FY07.

Per Figure 1, the Fund followed the positive performance of US and non-US public equity markets throughout the fiscal year. An increase in the Fund value occurred when the US

⁶ Money Manager fees range from 0.70% to 1.25% of assets under their respective management.

contribution was deposited. The Fund was mainly on an upward trend, except during market downturns towards the end of the Fund's first quarter and during the beginning and end of the Fund's fourth quarter. The Fund's non-discretionary assets contributed to smoothing out US and non-US public equity market trends.

Figure 1: FY14 Monthly Trust Fund Net Position
Dollars in millions



Source: Mercer Monthly Reports; contribution information from State Street Statement

For the fiscal year, in terms of performance measurement, the Fund grew 9.0% net of fees.⁷ The return rate compares to a Total Trust Benchmark of 10.6% and a Foundation Performance Universe Median of 8.5%.⁸

Table 6 provides Fund performance measures for the fund as whole, per portfolio category (managed assets and non discretionary assets) and per asset strategy, net of fees.

Table 6: Periodic and Since Inception Performance Compared to Benchmarks

	Market Value 9/30/14	%	FY14	3 Years	5 Years	Since Inception	Date of Inception
Total Fund	\$380,575,049	100.0%	9.0%	13.0%	9.8%	5.3%	Sep. 2004
Total Trust Benchmark			10.6%	14.6%	10.6%	5.9%	

⁷ The performance rates in this section are from the Mercer 9/30/14 Quarterly Report. The report contains performance measurements over different time periods and comparisons to various benchmarks for the fund as a whole, asset categories and individual asset strategies. The rates are different than the dollar-weighted annual rate of return that results from the audited asset values and all expenses including accrued expenses. The dollar-weighted return includes weighted earnings, expenses and contributions for a more true performance measurement. Figure 4 contains the dollar-weighted annual rate of return.

⁸ As of 1/1/14, the Total Trust Benchmark is comprised of 25.5% Russell 3000, 25.5% MSCI ACWIxUS Net Dividend, 19.0% fixed income benchmark, 10% NCREIF NFI ODCE, 9.5% S&P 500+3%, and 10.5% T-Bills+3%. The Foundation Performance Universe Median is a performance median of a Mercer pool of foundations, endowments and trust funds.

	Market Value 9/30/14	%	FY14	3 Years	5 Years	Since Inception	Date of Inception
Total Managed Assets	\$307,644,162	80.8%	8.8%	15.3%	NA	9.5%	Oct. 2010
U.S. Domestic Equity	\$107,611,518	28.3%	16.1%	22.3%	15.2%	7.9%	Jul. 2006
Russell 3000 Index			17.8%	23.1%	15.8%	7.9%	
US Large Cap Equity	\$78,047,204	20.5%	19.7%	23.0%	NA	16.4%	Oct. 2010
S&P 500			19.7%	23.0%	15.7%	16.40%	
US Small/Mid Cap Equity	\$29,564,314	7.7%	7.0%	20.6%	--	13.8%	Oct. 2010
Russell 2500			9.0%	22.8%	16.0%	15.3%	
Non-U.S. Equity	\$101,405,387	26.6%	5.3%	13.2%	7.6%	4.6%	Jul. 2006
Total Non-U.S. Equity Benchmark			4.8%	11.4%	5.3%	2.2%	
Fixed Income	\$75,401,929	19.8%	2.7%	3.6%	NA	3.5%	Oct. 2010
Fixed Income Benchmark			4.8%	2.7%	NA	3.3%	
Fixed Income - Core	\$10,224,735	2.7%	4.4%	4.1%	NA	3.9%	Oct. 2010
Barclays Aggregate			4.0%	2.4%	4.1%	3.1%	
Fixed Income - Opportunistic	\$65,177,194	17.1%	2.3%	NA	NA	4.9%	Aug. 2013
Custom Opportunistic Fixed Income Benchmark			2.3%	NA	NA	5.1%	
Hedge Fund	\$18,359,933	4.8%	6.8%	NA	NA	9.8%	Oct. 2012
T-Bills +3%			3.0%	3.1%	3.1%	3.0%	
HFRI Fund of Funds Composite Index			6.2%	5.2%	3.4%	6.8%	
Private Markets (Private Equity)	\$4,865,395	1.3%	-6.3%	NA	NA	NA	Apr. 2013
S&P 500 +3%			23.3%	26.6%	19.1%	22.4%	
Venture Economics All Private Equity Index			20.1%	14.0%	15.5%	19.3%	
Total Non Discretionary Assets	\$72,930,887	19.2%	12.2%	9.3%	10.0%	5.4%	Oct. 2004
Real Estate	\$37,333,520	9.8%	12.1%	11.5%	12.7%	0.7%	Mar. 2008
NCREIF NFI ODCE			12.4%	12.3%	12.4%	2.3%	
Hedge Fund	\$16,460,008	4.3%	8.2%	8.0%	NA	6.1%	Dec. 2009
T-Bills +3%			3.0%	3.1%	3.1%	3.1%	
Private Markets (Private Equity)	\$18,993,878	5.0%	19.7%	12.2%	14.3%	6.4%	Sep. 2006

	Market Value 9/30/14	%	FY14	3 Years	5 Years	Since Inception	Date of Inception
S&P 500 +3%			23.3%	26.6%	19.1%	10.7%	
Cambridge/Venture Economics All Private Equity Index			20.1%	14.0%	15.5%	10.7%	
Cash	\$143,481	0.0%					

Source: Mercer Quarterly Report, Period Ending September 30, 2014 and updates provided by Mercer
Notes: NA= Not Available; %'s based on performance net of fees

The Fund's asset class performance is described below, net of fees.

Total managed assets (80.8% of Fund value as of September 30, 2014) had an 8.8% gain. This gain underperformed the benchmark of 9.4% mainly due to weak performance of the small and mid cap growth and value funds, non-US equity and the fixed income strategy, described below.

US domestic equity investments (28.3% of the portfolio) had a 16.1% return that was below the benchmark of 17.8%. The large cap fund increased 19.7% equaling its benchmark. The small/mid cap equity strategy was up 7.0% but performed below its benchmark of 9%.

The non-US equity strategy (26.6% of the portfolio) had a positive return of 5.3% return beating the benchmark of 4.8%. The non-US equity asset had a return of 5.7%, above the benchmark of 4.3%. But, the emerging market equity asset underperformed its benchmark, achieving 3.4% growth versus a benchmark of 4.3%.

The fixed income strategy (19.8% of the portfolio) had a positive return of 2.7% underperforming its benchmark that had a 4.8% gain. The core income asset returned 4.4%, outperforming its benchmark that had a 4.0% return. The opportunistic fixed income asset returned 2.3% equaling its benchmark. The asset strategy includes the previously explained adjustment of assets in mid FY14 between the core and opportunistic funds.

The managed hedge fund strategy (4.8% of the portfolio) was added in early FY13 and has steadily built-up since that time. The strategy gained 6.8% for FY14, more than doubling the T-bills+3 benchmark performance. Since being added to the portfolio, the strategy has gained 9.8%.

The managed private equity fund strategy remained a minor component of the portfolio in FY14 (1.3% of the portfolio) and has not been a positive contributor to returns as of the end of FY14. Given the nature of private equity funds, the fund will continue to call capital over the next several years as the underlying Money Managers invest in private equity deals that may or may not come to fruition for several years. The managed private equity fund should also be considered with the more mature private equity investments, described below.

The non-discretionary component of the portfolio was reduced as a result of the adjustment of the fixed income assets to the managed fixed income strategy as described above. Thus, the non-discretionary assets comprised 19.2% of the portfolio versus 34.6% for FY13. The component outperformed the managed asset component with a 12.2% increase for FY14, providing additive returns to the Fund.

The real estate strategy (9.8% of the portfolio) had another gain following two years with similar gains (11.9% for FY13 and 10.4% for FY12). The strategy gained 12.1% for FY14, just below its benchmark of 12.4%.

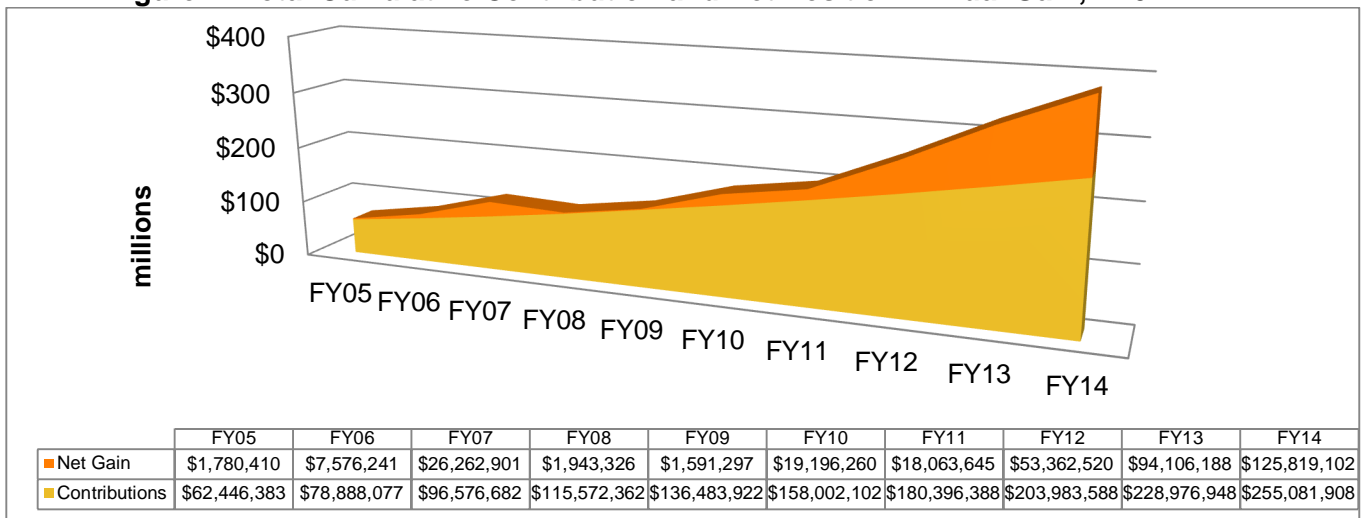
The non-discretionary hedge fund (4.3% of the portfolio) gained 8.2%, almost triple the benchmark's 3.0% performance. The Fund also outperformed the Mercer Institutional Funds of Hedge Funds (net) Median (6.6%).

The non-discretionary private equity strategy (5.0% of the portfolio) gained 19.7%, below its benchmark return of 23.3% (S&P 500 +3%) and closer to the Cambridge Global PE/Venture Economics All Private Equity Index benchmark (20.1% gain). For the more mature non-discretionary private equity strategy, distributions from the investments are being realized. As of the end of FY14, for both the managed and non-discretionary private equity strategy, the Fund had paid in capital of \$27.5 million of a total \$59.8 million commitment. Since the inception of these investments, \$12.1 million in distributions were received resulting in a 6.93% net internal rate of return that compares to a 5.24% net internal rate of return up to the end of FY13.

As of the end of FY14, the Fund's average annual return rate since inception was 5.3%, net of fees, below the Total Trust Benchmark (5.9%) and the Foundation Performance Universe Median (6.5%). The FY14 gain raises the average annual return rate since inception from 4.9% as of the end of FY13 and is more than double the FY11 average annual return rate of 2.2%.

Figure 2 shows the growth of the Fund with a steady incline of contributions and the periodic investment income gains and losses. As of FY14 a total of \$255,081,908 has been contributed to the Fund. The US government provided 88.1% of total contributions and the FSM government provided 11.9%. As of the end of FY14, the Fund has gained a total of \$125,819,102 from those contributions - 49.3% of the value of the contributions. No contributor's capital investment has been diminished since Fund inception.

Figure 2: Total Cumulative Contribution and Net Position Annual Gain, FY04-FY14

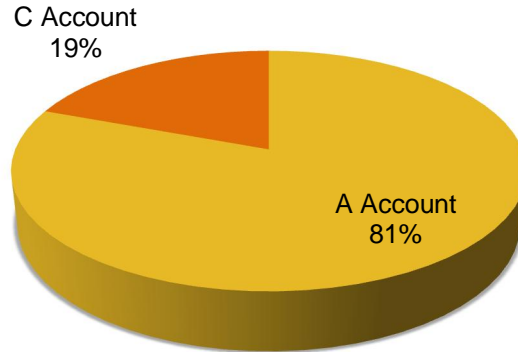


Source: Audited Financial Statements FY04-FY14

C. The C Account

Article 16 of the Trust Fund Agreement requires that any annual income on the Fund over 6% shall be transferred to the C account. The C account may be drawn upon, to the extent it contains sufficient funds, to address any shortfall in the B account after FY23, if income on the A account falls below the previous year's distribution adjusted for inflation and for Special Needs agreed to by the Committee.

Figure 3: FY14 A and C Account Breakdown
Source: FY14 Audited Financial Statements



The C account is maintained as a sub account for accounting purposes. It is not invested separately but as part of the overall corpus. The end-of-year financial statements provide a calculation to determine if the Fund achieved the 6% annual income threshold and, if so, the amount to be transferred to the C account. Also, the breakdown of the A and C accounts is reported annually by contributor as shown in Table 7. Historical account balances are provided as Attachment 3, Table C.

Given the positive investment gains in FY14, the 6% threshold was surpassed with an 8.72% dollar-weighted annual rate of return and the amount of \$9,895,700 was transferred to the C account. The total amount in the C account increased to \$73,672,363.

Table 7: A and C Account Net Position Balances, FY13-FY14

	FY13	FY14	FY14 % of Account
Total Assets	\$323,083,136	\$380,901,011	
A Account	\$259,306,473	\$307,228,648	100.00%
US	\$223,762,511	\$268,897,309	87.52%
FSM	\$35,543,962	\$38,331,339	12.48%
C Account	\$63,776,663	\$73,672,363	100.00%
US	\$55,034,593	\$64,480,641	87.52%
FSM	\$8,742,070	\$9,191,722	12.48%

Note: Amounts rounded to the nearest dollar. Source: Audited Annual Financial Statements FY13 and FY14

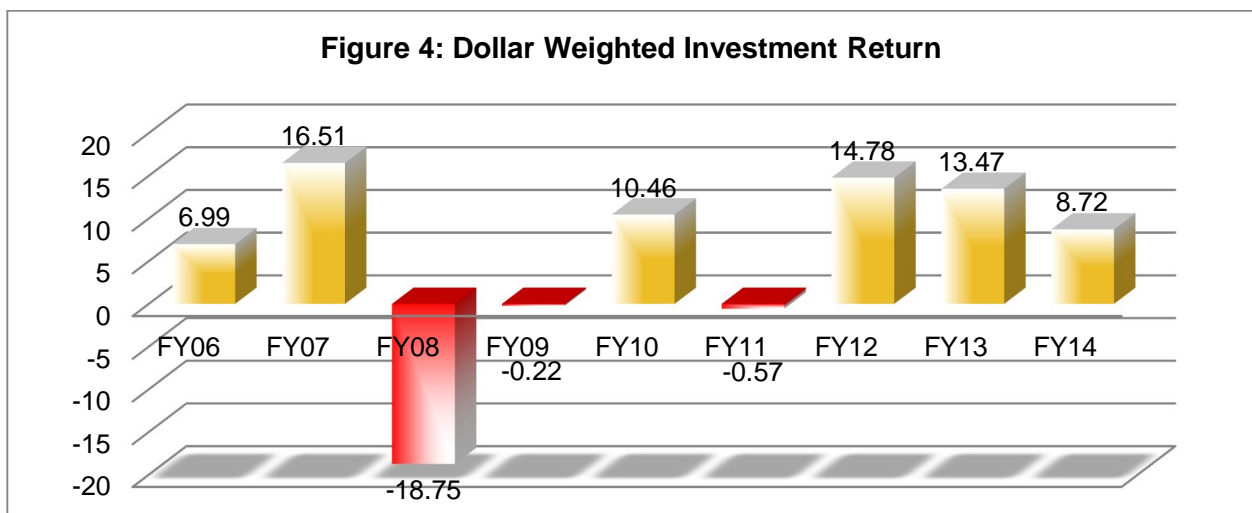
The C account has gained income in FY06, FY07, FY10, FY12, FY13 and FY14. Per the Trust Fund Agreement, the C account is allowed to contain up to three times the estimated equivalent of the Amended Compact's FY23 sector grant assistance plus an inflation adjustment. The current amount in the C account is 93.2% of estimated annual Amended Compact sector grant assistance for FY23.

IV. Trust Fund Effectiveness

A. Effectiveness to Achieve Purpose

Article 3 of the Trust Fund Agreement between the U.S. and FSM governments states that, “*The purpose of the Fund is to contribute to the economic advancement and long-term budgetary self-reliance of the Federated States of Micronesia by providing an annual source of revenue, after Fiscal Year 2023, for assistance in the sectors described in Section 211 of the Compact, as amended, or other sectors as mutually agreed by the Original Parties, with priorities in education and health care.*”

The Trust Fund Agreement states in Article 20 that the Committee shall publish an annual report that includes the “effectiveness of the Fund to accomplish its purpose” and may include “recommendations regarding improving the effectiveness of the Fund to accomplish that purpose.”



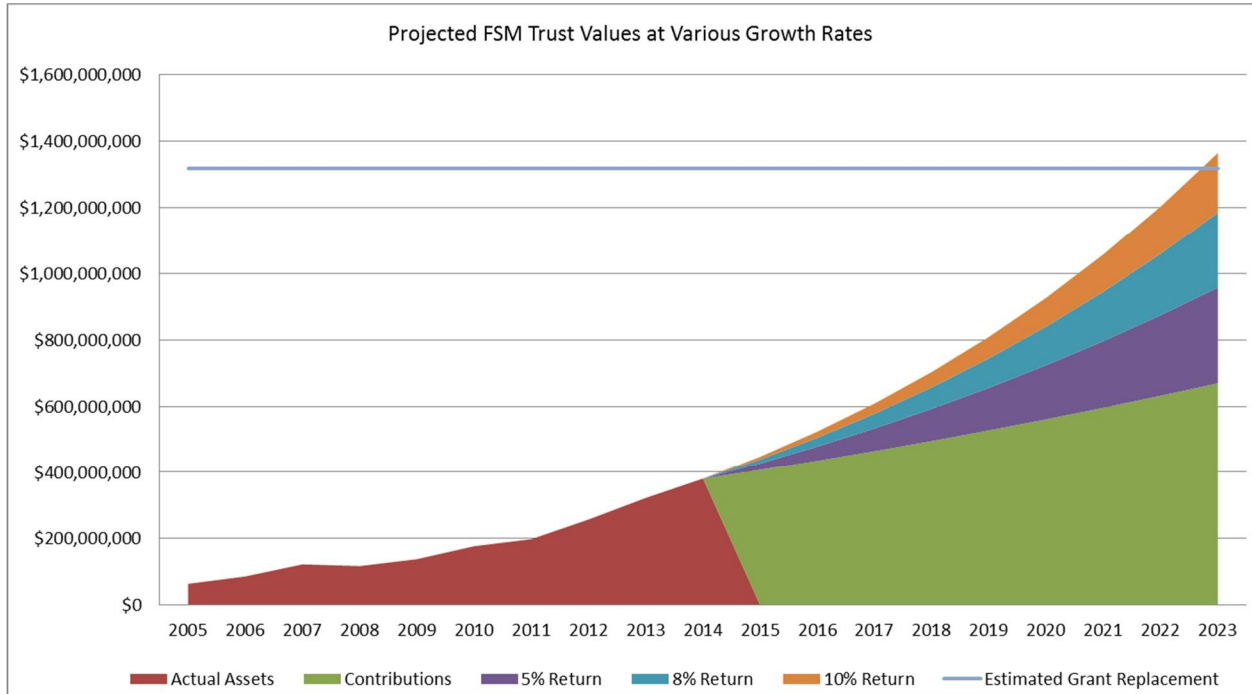
Source: Dollar Weighted Investment Return calculation is based on actual figures from the audited annual financial statements.

The Fund’s dollar-weighted annual rate of return on investment, after discounting for contributions, fees and expenses, was 8.72% for the year compared to two previous high return years of 13.47% for FY13 and 14.78% for FY12.

An analysis by the Investment Adviser (Figure 5) estimates that, assuming a 6% payout from the Fund, if the Fund manages an average 5% return annually from FY15 to FY23, the distribution from the estimated assets would provide for FY24 an amount equivalent to about 72.7% of the Amended Compact’s Section 211 estimated FY23 sector grant level with the partial inflation adjustment. There would also be a build-up of the C account but not to the maximum level permitted under the Trust Fund Agreement. As of FY14, the average annual rate of return is 5.3%, net of fees.

If the Fund were to achieve an average 8% return annually, the Fund would provide for FY24 an amount equivalent to 89.9% of estimated FY23 sector grant assistance with the partial inflation adjustment. There would also be a build-up of the C account but not to the maximum level permitted under the Trust Fund Agreement. The Fund has achieved 8% or more return in five fiscal years: 2007, 2010, 2012, 2013 and 2014.

Figure 5: Projected Growth Trends, FY04-FY23



Source: Mercer Investment Management

If the Fund were to achieve an average 10% return annually, the Fund would provide FY24 revenue equivalent to about 103.6% of estimated partially inflation adjusted FY23 sector grant assistance. However, it is unlikely that post-2023 distributions would provide for future inflation adjustments beyond the FY23 amount. The C account would achieve the maximum level permitted under the Trust Fund Agreement prior to FY 2023. However, there is a low probability of achieving such growth annually.

In addition to potential earnings on investment, analysis shows that additional contributions beyond those currently scheduled would improve the Fund's potential to achieve a value to provide sustainable distributions such as the Amended Compact's Section 211 FY23 sector grant level with the partial inflation adjustment and at least partially inflation adjusted amounts beyond.

Any growth projections are estimates, subject to fluctuation based on actual market performance. This also extends to future fiscal planning. As intended in the Amended Compact, Trust Fund payments will be a post-2023 "source of revenue" to supplement other financial resources of the FSM government.



B. Recommendations Moving Forward

The Trust Fund Committee had discussed during FY14 conducting an external independent and objective evaluation of the Fund during FY15. The evaluation will take place in FY15. The evaluation will provide the Committee with guidance over the medium term given that the Trust Fund is at the mid-term of its 20-year build-up that is scheduled to end in FY23.

Attachment 1: Manager Roster and Investment Manager Fee Schedule as of September 30, 2014

Account	Fee Schedule	Estimated Annual Fee (%)
Trust Fund Managed Assets	0.63% in aggregate of assets	0.63%
Private Equity- Mercer PIP III	0.50% of Committee Capital	0.50%
Non-Discretionary Assets		
Real Estate		
Prudential Real Estate Investors*	Effective Base Mgmt Fee+CF Distribution+Cash Mgmt Profit Distribution	0.95%
Hedge Fund		
Blackstone Alternative Asset Management*	1.25% of Assets	1.25%
Private Equity*		
HarbourVest Partners VIII Venture Fund	1.00% of Committed Capital	1.00%
HarbourVest Partners VIII Buyout Fund	1.00% of Committed Capital	1.00%
HarbourVest Partners VIII Mezzanine and Distressed Debt Fund	1.00% of Committed Capital	1.00%
HarbourVest International Private Equity V	1.00% of Committed Capital	1.00%
Portfolio Advisors Private Equity Fund I	0.70 of Committed Capital	0.70%
Total Non Discretionary Overlay Fee	0.09% of Assets	0.09%
Total Investment Management Fee		0.78%

Source: Trust Fund for the People of the Federated States of Micronesia Investment Performance, September 30, 2014, Mercer Investment Management, p. 107.

*The fee schedule rates are based on the manager's standard management fees only and do not include performance-based fees, incentives fees, etc.

Note: The management fees payable to third party investment managers to underlying funds in which Mercer PIP III may invest will be borne by that fund and therefore, indirectly by the Discretionary Account.

Attachment 2: Performance Standard Benchmarks

Asset Class	Benchmarks
Overall	Total Trust Benchmark ⁹ Ifx All Foundation Gross Median
Total Managed Assets Benchmark	Custom Bench Mark (as of 1/1/14): Russell 3000 (32.7%), MSCI ACWIxUS (33.8%), Fixed Income Benchmark (25.2%), T-Bills+3% (7.3%), and S&P 500+3% (1%)
Domestic Equity	Russell 3000 Index
US Large Cap Equity	S&P 500 Index (total return) Mercer Institutional US Equity Large Cap Core Median
US Small/Med Cap Equity	Russell 2500 Growth Index Mercer Institutional US Equity SMID Growth Median Russell 2500 Value Index Mercer Institutional US Equity SMID Value Median
Non-US Equity	Total Non-US Equity Benchmark (MSCI ACWI ex US Ne Div.) MSCI EAFE Mercer Institutional World ex US EAFE Equity Median MSCI Emerging Markets Mercer Institutional Emerging Markets Equity Median
Fixed Income	Fixed Income Benchmark (13.2% Barclays U.S. Aggregate Bond Index and 86.8% Custom Opportunistic Fixed Income Benchmark consisting of: 50% BofA Merrill Lynch Global High Yield Constrained Index and 50% JP Morgan WGBI EM Global Diversified) Mercer Institutional U.S. Fixed Combined Median Barclays Aggregate Bond Index (for Mercer Core Fixed Income Fund) Mercer Institutional U.S. Fixed Core Median Custom Opportunistic Fixed Income Benchmark (for Mercer Opportunistic Fixed Income) Mercer Institutional U.S. Fixed Core Opportunistic Median
Hedge Fund (managed)	T-Bills+3% HFRI Fund of Funds Composite Index Mercer Institutional Funds of Hedge Funds (Net) Median
Private Equity (managed)	S&P 500+3% Cambridge Global PE/Venture Economics All Private Equity Spliced Index

⁹ As of 1/1/14, the Total Trust Benchmark is comprised of 25.5% Russell 3000, 25.5% MSCI ACWIxUS Net Dividend, 19.0% fixed income benchmark, 10% NCREIF NFI ODCE, 9.5% S&P 500+3%, and 10.5% T-Bills+3%.



Asset Class	Benchmarks
Private Equity	S&P 500+3% Cambridge Global PE/Venture Economics All Private Equity Spliced Index
Private Real Estate	NCREIF NFI ODE Mercer Institutional US Real Estate Open End Median
Hedge Funds	T-Bills +3% Mercer Institutional Funds of Hedge Funds (Net) Median

Source: Trust Fund for the People of the Federated States of Micronesia Investment Performance, September 30, 2014, Mercer Investment Management.

Attachment 3: Historical Tables

Table A: Total Contributions, Income, Expenses and Net Positions Since Inception
(in millions)

	FY05	FY06	FY07	FY08	FY09	FY10	FY11	FY12	FY13	FY14
Net Assets (Beginning of FY)	\$0.00	\$64.23	\$86.46	\$122.84	\$117.52	\$138.07	\$177.20	\$198.46	\$257.34	\$323.08
<i>Contributions</i>										
US	\$32.19	\$16.44	\$17.69	\$19.00	\$20.91	\$21.52	\$22.39	\$23.59	\$24.99	\$26.10
FSM	\$30.26	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00
Total	\$62.45	\$16.44	\$17.69	\$19.00	\$20.91	\$21.52	\$22.39	\$23.59	\$24.99	\$26.10
<i>Investment Earnings Less Fees and Expenses</i>										
Investment Earnings	\$1.79	\$5.94	\$19.41	\$-23.27	\$0.83	\$18.70	\$-0.34	\$36.19	\$41.90	\$32.97
Fees and Expenses	\$0.01	\$0.14	\$0.73	\$1.05	\$1.18	\$1.09	\$0.79	\$0.89	\$1.15	\$1.26
Total	\$1.78	\$5.80	\$18.69	\$-24.32	\$-0.35	\$17.60	\$-1.13	\$35.29	\$40.74	\$31.71
Net Assets (End of FY)	\$64.23	\$86.46	\$122.84	\$117.52	\$138.07	\$177.20	\$198.46	\$257.34	\$323.08	\$380.90

Note: Amounts rounded.

Note: "Fees and Expenses" are not inclusive of all Money Manager fees given that in the Audited Annual Financial Statements those Money Manager fees are deducted directly from the respective asset's value. Table 5 provides all FY13 and FY14 expenses inclusive of Money Manager Fees deducted from the respective asset values.

Source: Audited Annual Financial Statements since FY05.

Table B: Investment and Administrative Expenses Since Inception and Differences Between FY13 and FY14

	FY05	FY06	FY07	FY08	FY09	FY10	FY11	FY12	FY13	FY14	Diff FY13- FY14
Investment Expenses	\$0	\$132,039	\$686,419	\$955,763	\$1,049,150	\$939,224	\$645,382	\$2,177,580	\$2,613,679	\$2,849,842	9.0%
Custodian	-	1,997	12,908	42,117	16,280	23,508	59,312	67,313	85,449	98,437	15.2%
Investment Adviser	-	125,385	142,402	126,800	187,754	319,704	162,496	179,738	359,658	402,713	12.0%
Money Manager	-	4,657	531,109	786,846	845,116	596,012	423,574	490,898	555,169	604,209	8.8%
Money Manager*								1,439,631	1,613,403	1,744,483	8.1%
<i>% of Net Position</i>	<i>0.00%</i>	<i>0.15%</i>	<i>0.56%</i>	<i>0.81%</i>	<i>0.76%</i>	<i>0.53%</i>	<i>0.33%</i>	<i>0.85%</i>	<i>0.81%</i>	<i>0.75%</i>	<i>-7.5%</i>
Administrative Expenses	\$13,356	\$9,458	\$39,715	\$93,851	\$133,959	\$152,679	\$147,921	\$156,960	\$153,346	\$154,481	0.7%
Executive Administrator	-	-	-	70,650	85,650	91,850	96,816	102,760	98,280	99,904	1.7%
Audit Fees	-	-	33,906	15,260	39,740	45,062	42,446	39,900	41,088	42,395	3.2%
Accounting Fees	-	-	-	3,449	5,868	6,295	6,794	6,639	5,893	6,059	2.8%
Legal Fees	13,356	9,458	5,809	4,457	245	4,344	1,258	780	2,889	376	-87.0%
Miscellaneous Fees	-	-	-	35	2,456	5,128	607	6,881	5,197	5,747	10.6%
<i>% of Net Position</i>	<i>0.02%</i>	<i>0.01%</i>	<i>0.03%</i>	<i>0.08%</i>	<i>0.10%</i>	<i>0.09%</i>	<i>0.07%</i>	<i>0.06%</i>	<i>0.05%</i>	<i>0.04%</i>	<i>-14.6%</i>
Total Expenses	\$13,356	\$141,497	\$726,134	\$1,049,614	\$1,183,109	\$1,091,903	\$793,303	\$2,334,540	\$2,767,025	\$3,004,323	8.6%
<i>Total % of Net Position</i>	<i>0.02%</i>	<i>0.16%</i>	<i>0.59%</i>	<i>0.89%</i>	<i>0.86%</i>	<i>0.62%</i>	<i>0.40%</i>	<i>0.91%</i>	<i>0.86%</i>	<i>0.79%</i>	<i>-7.9%</i>

Note: Amounts rounded.

Source: Audited Annual Financial Statements since FY05

Note: Categories are organized and dollar figures reported per the Audited Annual Financial Statements except for the inclusion of Money Manager* fees. These Money Manager* fees are those fees directly deducted from individual fund asset values. The Money Manager* fees were recorded as of FY12 by Trust Fund administration. Such Money Manager* fees were incurred prior to FY12 but not fully recorded.

Table C: A and C Account Net Position Balances, FY06-FY14

	FY06	FY07	FY08	FY09	FY10	FY11	FY12	FY13	FY14
Total Net Position	\$86,464,317	\$122,839,583	\$117,515,688	\$138,075,219	\$177,198,362	\$198,460,033	\$257,346,108	\$323,083,136	\$380,901,011
<i>A Account</i>	\$85,645,391	\$110,126,326	\$104,802,431	\$125,361,962	\$156,981,440	\$178,243,111	\$216,162,380	\$259,306,473	\$307,228,648
US	52,597,064	74,902,144	76,325,412	96,967,855	126,458,760	147,930,868	183,186,779	223,762,511	268,897,309
FSM	33,048,327	35,224,182	28,477,019	28,394,107	30,522,680	30,312,243	32,975,601	35,543,962	38,331,339
<i>C Account</i>	\$818,926	\$12,713,257	\$12,713,257	\$12,713,257	\$20,216,922	\$20,216,922	\$41,183,728	\$63,776,663	\$73,672,363
US	502,911	8,587,013	8,587,013	8,587,013	13,655,271	13,655,271	34,901,145	55,034,593	64,480,641
FSM	316,015	4,126,244	4,126,244	4,126,244	6,561,651	6,561,651	6,282,583	8,742,070	9,191,722

Notes: Amounts rounded.

Source: Audited Annual Financial Statements since FY06

